OPEN MEETING AGENDA ITEM

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BEFORE THE ARIZONA CORPORATION C

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IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS ELECTRIC, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA AND REQUEST FOR APPROVAL OF RELATED FINANCING.

DOCKET NO. E-04204A-06-0783

REVISION TO STAFF'S REQUEST FOR CLARIFICATION AND LIMITED EXCEPTIONS

On May 6, 2008, Staff filed its Request for Clarification and Limited Exceptions in this case. In preparing for the May 14, 2008 Open Meeting on this matter, Staff noted an accounting issue raised by the Company in its case in chief; that the Company also addressed in its Line Extension Tariff. While Judge Nodes addressed the issue in his Recommended Opinion and Order ("ROO"), Staff seeks through this filing to simply ensure consistency between the ROO and the Company's Line Extension tariff.

Staff seeks clarification of the ratemaking treatment of Accumulated Deferred Income Taxes ("ADIT") on Customer Advances and Contributions in Aid of Construction ("CIAC") and a suggested revision to the Line Extension Rules and Regulations tariff proposed by UNSE. Staff wishes to have the Commission clarify that ADIT on Customer Advances and CIAC are only includable in rate base if the rate base has been reduced by the related Customer Advances and CIAC. As described at page 10, lines 19-21 of the proposed decision, Customer Advances represent customer-supplied funds that are properly deducted from the Company's rate base. The Company's rate base is appropriately reduced by the amount of Customer Advances and ADIT related to customer advances is reflected in rate base. UNS Electric records CIAC as a direct credit to the related plant per the FERC Uniform System of Accounts (USOA). As such, the plant balance has

been reduced by the CIAC. Another way of accounting for CIAC is to record it as a liability in Account 271, which would be a separate reduction from rate base. The latter treatment is specified in the NARUC USOA. See pages 11-12 of the proposed decision for an issue of dispute between UNSE and RUCO about this.

As UNSE witness Kissinger pointed out, pursuant to Decision No. 55774 (October 21, 1987), the Company is permitted to record the ADIT related to CIAC as a deferred tax asset (i.e., to record the related ADIT in Account 190) and claim rate base treatment for that when using the self-pay method. (See, Ex. A-12, at 6-9, as cited on page 12, lines 5-7 of the proposed decision.)

UNSE proposed to revise the Rules and Regulations provisions in its tariffs, specifically Section 9-F, which addresses Line Extensions, to add a provision stating that: "Any federal, state or local income taxes resulting from the receipt of a contribution or advance in aid of construction in compliance with this rule is the responsibility of the Company and will be recorded as a deferred tax asset and reflected in the Company's rate base for ratemaking purposes."

A similar provision had been included in the Rules and Regulations section for UNS Gas' Line Extension tariff, but which has somewhat different wording: "Any federal, state or local income taxes resulting from a nonrefundable contribution or advance by the Customer in compliance with this rule will be recorded as a deferred tax and appropriately reflected in the Company's rate base."

A similar provision has also been proposed by their affiliate, Tucson Electric Power Company ("TEP") in TEP's current rate case, and is under discussion as part of the settlement talks in that case. Staff believes that whether or not the related ADIT item is included in rate base is dependent upon how the corresponding Customer Advances and CIAC have been treated for ratemaking purposes.

Staff's first concern is that these matters are being included in tariffs. Staff believes like other accounting issues, they are more appropriately addressed in each Company's rate case, rather than being specified in the rules and regulations section of the utility's tariff.

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For example, UNSE advocated in the current case that Customer Advances be ignored for rate base purposes. While the Judge appropriately did not adopt UNSE's recommendation, if the Commission does, there could be a mis-match by including ADIT on Customer Advances in rate base, while not deducting Customer Advances from rate base.

Because of this, Staff seeks a clarification that whether or not the related ADIT item should be included in rate base is dependent upon how the related Customer Advances and CIAC have been treated for ratemaking purposes. Since this should be a determination in each rate case, Staff believes the phrase "and reflected in the Company's rate base for ratemaking purposes" should be deleted from UNSE's Line Extension rules and regulations tariff.

To take the ratemaking treatment ordered in each case into account, the provision should instead read: "Any federal, state or local income taxes resulting from the receipt of a contribution or advance in aid of construction in compliance with this rule is the responsibility of the Company and will be recorded as a deferred tax asset." Alternatively, Staff would suggest the following clarification be used to specify that the ratemaking treatment of the ADIT asset should match the related Customer Advance or CIAC and be determined in a rate case, where those items can be reviewed: "Any federal, state or local income taxes resulting from the receipt of a contribution or advance in aid of construction in compliance with this rule is the responsibility of the Company and will be recorded as a deferred tax asset, with the ratemaking treatment of the deferred tax asset to be determined in the Company's rate case consistent with the rate base treatment of the related customer advance or CIAC."

Another issue arises upon review of Decision No. 55774 which was referenced by the Company. The UNSE proposed revision to its Line Extension rules, also would add an option for UNSE to require an applicant to include a tax gross up. It provides in part: " if the estimated cost of facilities for any service line or distribution main extension exceeds $500,000, the Company may require the Applicant to include in the contribution or advance an amount (the "gross up amount") equal to the estimated federal, state or local income tax liability of the Company resulting from the contribution or advance…"

This would appear to be contradicted by the guidance provided in Decision No. 55774 at page 3, lines 15-18 which provides: "If the utility has elected to self-pay the associated tax on all contributions, all advances, or both, then the Utilities Division will assure that the utility does not then require some contributions or advances be grossed-up for tax purposes." That Decision had also provided at page 2, lines 15-19, the following Staff recommendation (which appears to have been adopted by the Commission) that: "...once a utility has chosen a method to accommodate the tax liability associated with all contributions, all advances, or both, the utility utilizes the method for all contributions, all advances, or both on a non-discriminatory basis." The UNSE tariff provision would appear to violate this guidance by providing that some contributions or advances be grossed-up for tax purposes.

If the threshold is going to be specified such that line extensions over $500,000 require that the Applicant pay a gross-up for the income tax amount, this should be nondiscriminatory, and not left to the option of the utility. The "may require" language proposed by UNSE should therefore be revised.

Finally, the Staff also noted what appears to be a discrepancy with the Company's other tariffs on customer disconnections. UNSE's tariff states that a customer's service shall be terminated without notice if the customer's check, EFT or other financial instrument is returned for non-sufficient funds. Recognizing that this occurrence may simply be a result of err on the customer's part, Staff believes that the customer should be given notice so he or she has an opportunity to make good on his check, EFT or other financial instrument. Disconnection of service, especially in the summer months in Arizona, is a serious matter.

RESPECTFULLY SUBMITTED this 8th day of May, 2008.

Maureen A. Scott, Senior Staff Counsel
Legal Division
1200 West Washington Street
Phoenix, Arizona 85007

Original and thirteen (13) copies
of the foregoing filed this
8th day of May, 2008 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copies of the foregoing mailed this
9th day of May, 2008 to:

Michael W. Patten
Roshka DeWulf & Patten PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

Michelle Livengood
Unisource Energy Services
One South Church Street, Suite 200
Tucson, Arizona 85702

Thomas L. Mumaw
Deborah A. Scott
Pinnacle West Capital Corp.
Post Office Box 53999, Mail Station 8695
Phoenix, Arizona 85072-3999

Barbara A. Klemstine
Arizona Public Service Company
Post Office Box 53999, Mail Station 9708
Phoenix, Arizona 85072-3999

Robert J. Metli
Snell & Wilmer, L.L.P.
One Arizona Center
400 East Van Buren Street
Phoenix, Arizona 85004-2202

Marshall Magruder
Post Office Box 1267
Tubac, Arizona 85646-1267

. . .

Scott S. Wakefield
Chief Counsel
RUCO
1110 West Washington
Suite 200
Phoenix, Arizona 85007